No.

In the Supreme Court of the United States

OCTOBER TERM, 1976

76-1800

UNITED STATES OF AMERICA, PETITIONER

v.

ONOFRE J. SOTELO and NAOMI SOTELO

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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The Solicitor General, on behalf of the United States, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The opinions of the bankruptcy court (App. A, *infra*, pp. 1a-14a) and of the district court (App. B, *infra*, pp. 15a-16a) are not officially reported. The opinion of the court of appeals (App. C, *infra*, pp. 17a-22a) is reported at 551 F.2d 1090.

JURISDICTION

The judgment of the court of appeals was entered on March 24, 1977 (App. D, *infra*, pp. 23a-24a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the liability equal to unpaid taxes withheld from employees' wages that is imposed by Section 6672 of the Internal Revenue Code of 1954 upon persons who are required to collect and pay over such taxes but who willfully fail to do so is dischargeable under Section 17 of the Bankruptcy Act.

STATUTES INVOLVED

Section 6672 of the Internal Revenue Code of 1954 (26 U.S.C.) and Section 17 of the Bankruptcy Act (11 U.S.C. 35) are set forth in Appendix E, *infra*, pp. 25a-26a.

STATEMENT

On June 26, 1973, O. J. Sotelo and Son Masonry Inc., a corporation, was adjudicated a bankrupt. Respondents Onofre J. Sotelo and his wife, Naomi Sotelo, served respectively as president (chief executive officer) and secretary of the corporation (App. A, *infra*, p. 1a). Shortly thereafter, on July 5, 1973, respondents were adjudicated bankrupts on their voluntary petitions and their individual bankruptcy proceedings were consolidated (App. A, *infra*, p. 1a). On November 5, 1973, the government filed a claim

in the consolidated cases for $40,751.16 for unpaid taxes withheld from the corporation's employees, penalties, and interest. The government's tax claim was based upon Section 6672 of the Internal Revenue Code of 1954, which imposes personal liability for unpaid withholding taxes upon persons responsible for collecting and paying over taxes withheld from employees' wages, but who wilfully fail to do so (App. A, *infra*, pp. 1a-2a). The Internal Revenue Service thereafter assessed these liabilities.

The bankrupts objected to the claim on the ground that neither was an officer of the corporation responsible for collecting and paying the withholding taxes over to the government (App. A, *infra*, p. 2a). The trustee objected to the government's claim on the ground that the withholding tax liability was a corporate obligation that was not personally guaranteed by the bankrupts (App. A, *infra*, p. 2a). Following a trial of these issues, the bankruptcy court found that respondent Onofre J. Sotelo, in his capacity as chief executive officer and majority stockholder of the corporation, had been responsible to collect and pay over the withholding taxes and was therefore personally liable for the taxes under Section 6672 of the Code. However, the bankruptcy court further found that respondent Naomi Sotelo was not personally liable for the taxes because she had not been responsible for their collection and payment (App. A, *infra*, p. 2a).

On October 2, 1975, the government served a notice of levy on the trustee with respect to $10,000 that had

been set aside as respondent Onofre J. Sotelo's homestead exemption (App. A, *infra*, p. 4a).[1] The trustee thereafter sought an order of the bankruptcy court directing that the homestead funds be paid to the government (App. A, *infra*, p. 4a). However, respondents objected to the payment of the $10,000 to the government on the grounds that the liability for unpaid withholding taxes under Section 6672 was a dischargeable compensatory penalty rather than a tax, and that the homestead exemption belonged to respondent Naomi Sotelo (App. A, *infra*, pp. 4a, 10a). The bankruptcy court held that respondent Onofre J. Sotelo's Section 6672 liability was a non-dischargeable tax under Section 17a of the Bankruptcy Act, and that the homestead exemption belonged solely to him, as the head of the household (App. A, *infra*, pp. 6a-9a, 10a-12a). The district court affirmed on the basis of the opinion of the bankruptcy court (App. B, *infra*, pp. 15a-16a).

The court of appeals reversed. It held that the liability imposed by Section 6672 was a debt that was dischargeable in respondent's personal bankruptcy and was not a non-dischargeable tax (App. C, *infra*, pp. 19a, 22a). In the court of appeals' view, the use of the word "penalty" in Section 6672 to describe the

[1] Prior to the date on which the government filed its claim, the trustee allowed respondent Onofre J. Sotelo a homestead exemption in certain real estate which respondents held as joint tenants (App. A, *infra*, p. 3a). The real estate was sold subject to certain liens, and the trustee set aside $10,000 as Onofre J. Sotelo's homestead exemption (App. A, *infra*, p. 3a).

liability showed that it was not a tax. In so holding, the court acknowledged that its decision conflicted with *Murphy* v. *Internal Revenue Service*, 533 F.2d 941 (C.A. 5), affirming 381 F. Supp. 813 (N.D. Ala.), and those of many lower courts that Section 6672 was a collection device and the liability it imposed equal to unpaid withholding taxes was in fact a non-dischargeable "tax" within the meaning of Section 17a (1) of the Bankruptcy Act (App. C, *infra*, p. 19a).

The court rejected the government's further argument that the liability was non-dischargeable under Section 17a(1)(e) of the Bankruptcy Act, which provides that taxes "which the bankrupt has collected or withheld from others as required by the laws of the United States * * * but has not paid over" shall not be dischargeable. Despite its literal applicability, the court concluded that respondent's Section 6672 liability was dischargeable because it was a "penalty" and not a "tax" and because the corporation and not respondent was required to collect and pay over the withholding taxes in the first instance (App. C, *infra*, pp. 20a-21a).

REASONS FOR GRANTING THE WRIT

In holding that the liability imposed by Section 6672 of the Internal Revenue Code for unpaid withholding taxes is dischargeable in the bankruptcy of the person who willfully failed to pay over such taxes, the court of appeals acknowledged that its decision was in conflict with *Murphy* v. *Internal Revenue Serv-*

ice, 533 F.2d 941 (C.A. 5), affirming 381 F. Supp. 813, 816-817 (N.D. Ala.) (App. C, *infra*, pp. 19a, 22a n. 4). There, the Fifth Circuit held that the liability imposed by Section 6672 was a non-dischargeable debt for taxes within the meaning of Section 17a(1) of the Bankruptcy Act (11 U.S.C. 35 (a)(1)) (App. E, *infra*, pp. 25a-26a). The decision also conflicts with *Lackey* v. *United States*, 538 F.2d 592 (C.A. 4), which likewise held that the Section 6672 liability is a non-dischargeable tax obligation. Thus, the decision below is contrary to those of two other courts of appeals. Resolution of the conflict by this Court is essential in order that there be a uniform national rule with respect to this issue involving the administration of both the Bankruptcy Act and the Internal Revenue Code.

Moreover, the question whether the Section 6672 personal liability for unpaid withholding taxes is dischargeable in the bankruptcy of the person responsible for the collection and payment of such taxes is of substantial fiscal importance. We are advised by the Internal Revenue Service that for the fiscal year 1976, there were $2 billion in withholding tax delinquencies which resulted in assessments under Section 6672 totalling $61 million. Under the decision below, the Internal Revenue Service believes that the collectibility of the major portion of the annual $61 million in withholding tax delinquencies will be jeopardized, since corporate officers will be able to avoid their Section 6672 obligation for corporate withholding taxes by instituting personal bankruptcy proceed-

ings. Indeed, the availability of personal bankruptcy as a shield against Section 6672 liability would mitigate the consequences of failure to pay over withholding taxes and serve to lessen the incentive of corporate officers to collect and pay over such taxes conscientiously. The threat to the integrity of the withholding system posed by the decision below calls for review by this Court.

1. Section 6672 of the Internal Revenue Code of 1954, Appendix E, *infra*, p. 25a, provides that "Any person required to collect * * * and pay over any tax * * * who willfully fails to collect such tax, or truthfully account for and pay over such tax, * * * shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over." The thrust of the statute is to impose personal liability upon those whose control of the financial affairs of a business entity requires them to collect and pay over taxes collected from third parties.

In the typical case, as here, the statute is used as a collection device against corporate officers for the income taxes withheld from their employees' wages. See, *e.g.*, *Monday* v. *United States*, 421 F.2d 1210, 1215 (C.A. 7), certiorari denied, 400 U.S. 821; *Gefe[illegible]* v. *United States*, 400 F.2d 476, 482 (C.A. 5), certiorari denied, 393 U.S. 1119; *Hewitt* v. *United States*, 377 F.2d 921, 924 (C.A. 5); *Burack* v. *United States*, 461 F.2d 1282, 1285 (Ct. Cl.); 8A Mertens, *Law of Federal Income Taxation*, § 47A.25a, pp. 207-

215 Rev. 1971).[2] Thus, except for the present decision, the courts have uniformly recognized that the liability imposed by Section 6672 is a pecuniary burden to insure the collection of unpaid withholding taxes and other taxes that the Code required certain persons to collect from third parties.[3] *Harrington* v. *United States*, 504 F.2d 1306, 1311 (C.A. 1); *Spivak* v. *United States*, 370 F.2d 612, 616 (C.A. 2), certiorari denied, 387 U.S. 908; *Cross* v. *United States*, 311 F.2d 90, 94 (C.A. 4); *Newsome* v. *United States*, 431 F.2d 742, 745 (C.A. 5); *Mueller* v. *Nixon*, 470 F.2d 1348, 1350 (C.A. 6); *Monday* v. *United States*, *supra*, 421 F.2d at 1216; *Kelly* v. *Lethert*, 362 F.2d 629, 633 (C.A. 8); *Bloom* v. *United States*, 272 F.2d 215, 223 (C.A. 9), certiorari denied, 363 U.S. 803.

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[2] While Section 6672 is most frequently asserted against corporate officers, the provision also applies to partners, lenders, and others. See, *e.g.*, *Mueller* v. *Nixon*, 470 F.2d 1348, 1349-1350 (C.A. 6), certiorari denied, 412 U.S. 949 (officer of a second corporation); *Adams* v. *United States*, 504 F.2d 73, 75-76 (C.A. 7) (finance company); *Pacific National Ins. Co.* v. *United States*, 422 F.2d 26, 29-30 (C.A. 9), certiorari denied, 398 U.S. 937 (surety); *Werner* v. *United States*, 512 F.2d 1381, 1382 (C.A. 2) (creditor); *Genins* v. *United States*, 489 F.2d 95, 96 (C.A. 5) (partner).

[3] Thus, apart from an employer's obligation to collect and pay over income taxes withheld from his employees' wages (26 U.S.C. 3402, 3403), he is likewise required to collect and pay over Federal Insurance Contribution Act (social security) taxes (26 U.S.C. 3102(a) and (b)); and Railroad Retirement Act taxes (26 U.S.C. 3202). Furthemore, the Code requires sellers and others to collect and pay over certain excise taxes. See, *e.g.*, 26 U.S.C. 4061 *et seq.*

In holding that respondent's Section 6672 liability was dischargeable in his personal bankruptcy, the court of appeals erroneously refused to apply Section 17a(1)(e) of the Bankruptcy Act (App. E, *infra*, pp. 25a-26a), which controls this case. That provision states that "a discharge in bankruptcy shall not release a bankrupt from any taxes * * * which the bankrupt has collected or withheld from others as required by the laws of the United States * * *." Since respondent had withheld taxes from the wages of his corporation's employees, pursuant to the requirements of 26 U.S.C. 3402, the language of Section 17a(1)(e) directs that the liability imposed by Section 6672 upon an officer of a business entity to pay such taxes is not dischargeable in bankruptcy.

This reading of the statute is confirmed by the pertinent legislative history of Section 17a(1)(e). Prior to the 1966 amendment of Section 17, the Treasury had consistently objected to proposals before Congress that would have made the Section 6672 liability dischargeable in bankruptcy. As the Treasury pointed out, such proposals "would thus discharge or reduce the priority of liabilities resulting not from the bankrupt's failure to pay his own taxes but from his failure to keep intact money which he had obtained from others as a trustee for the Government." H.R. Rep. No. 2535, 85th Cong., 2d Sess. 6 (1958). Congress initially declined to adopt the Treasury's position in favor of non-dischargeability on the belief that the enactment of a criminal penalty (26 U.S.C. 7215) against persons who fail to pay over withhold-

ing taxes would supplement the Section 6672 collection device. See H.R. Rep. No. 2535, *supra*, at 5; S. Rep. No. 1182, 85th Cong., 2d Sess. 1, 2 (1958).

Despite the enactment of the criminal statute, the Treasury continued to press for non-dischargeability in bankruptcy of the obligation to pay withholding taxes in order to enhance the collectibility of such taxes, which "shall be held to be a special fund in trust for the United States" (26 U.S.C. 7501). See H.R. Rep. No. 735, 86th Cong., 1st Sess. 5-7 (1959); H.R. Rep. No. 372, 88th Cong., 1st Sess. 6 (1963). In response, Congress added subsection (e) to Section 17a(1) in 1966. As the House Committee Report stated, its purpose was "to exempt from the provisions of this bill taxes which the bankrupt has collected or withheld from others under Federal or State law." H.R. Rep. No. 372, *supra*, at 1. In the House Committee's view, "* * * the objection of Treasury to the discharge of so-called trust fund taxes has been met by the amendment to this bill." *Id.* at 5. The Senate Reports likewise confirm that the purpose of Section 17a(1)(e) was to render trust fund taxes non-dischargeable in bankruptcy. S. Rep. No. 1134, 88th Cong., 2d Sess. 1, 6 (1964); S. Rep. No. 114, 89th Cong., 1st Sess. 6 (1965).

In light of this legislative history, there is no basis for the court of appeals' conclusion (App. C, *infra*, p. 21a) that Section 17a(1)(e) applies only to the corporate employer and not to the Section 6672 liability of the officer responsible for the collection and payment of withheld taxes. Indeed, there would have

been little reason for Congress to render non-dischargeable the corporate employer's obligation to pay withholding taxes since it was fully aware that for all practical purposes a corporation ceases to exist after a liquidating bankruptcy. See, *e.g.*, H.R. Rep. No. 735, *supra*, at 2; S. Rep. No. 114, *supra*, at 2-3. Thus, in providing for the non-dischargeability of "taxes * * * which the bankrupt has collected or withheld from others," Congress intended that the obligation to pay over such taxes that Section 6672 imposes upon a corporate officer such as respondent survive his personal bankruptcy.

2. The court of appeals also erred in holding that respondent's Section 6672 liability was a dischargeable compensatory "penalty" rather than a non-dischargeable obligation for "taxes * * * legally due and owing by the bankrupt to the United States * * *" within the meaning of Section 17a(1) of the Bankruptcy Act.[4] In so concluding, the court relied upon the use of the word "penalty" in Section 6672 to describe a corporate officer's personal obligation for unpaid taxes withheld from the wages of the corporation's employees.[5] But until the decision below, the courts

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[4] Section 17a(1) provides for the non-dischargeability of taxes which became due "within three years preceding bankruptcy." The three-year limitation presents no problem in this case because the withholding taxes were due to be paid in 1971 and 1973 and respondent's bankruptcy petition was filed on July 5, 1973 (App. A, *infra*, p. 1a).

[5] If the court had classified the Section 6672 liability as a non-compensatory penalty, presumably it would have held that the liability was non-dischargeable. Because the purpose of

had uniformly characterized the Section 6672 obligation as a non-dischargeable tax imposed upon persons who should have paid over taxes collected from third persons but who willfully failed to do so. Thus, the liability under Section 6672 "is not a penalty as that term is generally used, but in reality is a liability for a tax originally imposed upon the corporation and shifted to the corporate officer upon his default. Being a tax due from the bankrupt to the United States, this penalty was therefore not dischargeable under Section 17 [footnote omitted]." *Sherwood* v. *United States*, 228 F. Supp. 247, 251 (E.D. N.Y.). Accord: *Murphy* v. *Internal Revenue Service*, 533 F.2d 941 (C.A. 5), affirming 381 F.Supp. 813, 816-817 (N.D. Ala.); *Lynn* v. *Scanlon*, 234 F. Supp. 140, 144-145 (E.D. N.Y.); *Westenberg* v. *United States*, 285 F. Supp. 915, 917 (D. Ariz.). Since Section 6672 is a device to collect what are undisputably taxes, the liability it imposes upon persons responsible for their collection and payment is likewise a non-dischargeable "tax" within the meaning of Section 17a(1). Respondent's liability under Section 6672 is no less a tax liability because his corporation was also liable for the taxes.

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such a penalty is to punish the bankrupt rather than his creditors, penalties are not allowable out of the assets of the bankruptcy estate and are non-dischargeable. See 1A *Collier on Bankruptcy*, ¶¶ 17.05, 17.13 (14th ed.); Bankruptcy Act, c. 541, Section 57j, 30 Stat. 561, as amended (11 U.S.C. 93(j)); *Simonson* v. *Granquist*, 369 U.S. 38. However, compensatory penalties are allowable under Section 57j of the Bankruptcy Act and, as such, are presumptively dischargeable. 8 *Remington on Bankruptcy*, § 3304 (6th ed.).

3. Finally, the court of appeals observed that "[a]s a policy matter, the government's position that [respondent] remains personally liable, notwithstanding bankruptcy, for taxes required to be withheld by his corporation, can lead to substantial inequities" (App. C, *infra*, p. 21a). In the court's view, there is no nexus between the estate of an individual bankrupt corporate officer and the liability of his corporation for unpaid withholding taxes.

But Section 6672 creates the nexus the court believed to be lacking by imposing personal liability for such taxes upon the officer whose preference of other creditors over the government benefitted his corporation in the first instance. Thus, there is no inequity in providing that the corporate officer whose actions resulted in the corporation's withholding tax delinquency cannot eliminate his liability for those taxes by means of personal bankruptcy. Nor do the court of appeals' generalizations concerning the humanitarian policy of the Bankruptcy Act to provide a debtor with a fresh start answer the question whether the liability imposed by Section 6672 is dischargeable under Section 17. As this Court stated in an analogous context in *Bruning* v. *United States*, 376 U.S. 358, 361, "§ 17 is not a compassionate section for debtors * * * [but] demonstrates congressional judgment that certain problems—*e.g.*, those of financing government—override the value of giving the debtor a wholly fresh start [footnote omitted]."

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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JUNE 1977.

APPENDIX A

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS
NORTHERN DIVISION

Bankruptcy No. RI BK 73 233 &
Bankruptcy No. RI BK 73 234

MERGED CASES

[Filed Jan. 23, 1976, Max J. Lipkin,
Bankruptcy Judge]

IN THE MATTER OF

ONOFRE J. SOTELO AND NAOMI SOTELO, BANKRUPTS.

OPINION

Introduction

On June 26, 1973 O. J. Sotelo and Son Masonry Inc., a corporation, was adjudicated a bankrupt. O. J. Sotelo was President and chief executive officer and Naomi Sotelo, his wife, was Secretary.

On July 5, 1973 Mr. & Mrs. Sotelo were adjudicated bankrupts as a result of individual petitions filed by them. These cases were merged by Order of Court on October 12, 1973.

On November 5, 1973 the Internal Revenue Service filed a claim in the amount of $40,751.16 in the merged bankruptcy cases, based on the provisions of Section 6672 of the Internal Revenue Code, which pro-

vides in substance that any person required to collect and pay over any tax imposed by the Internal Revenue Code shall be liable to a penalty equal to the total amount of the tax not paid over.

On March 7, 1974 the Trustee of their estates filed an objection to this claim on the ground that the claim was a claim against the corporation and not personally guaranteed by the bankrupts. The United States of America filed a Motion in Opposition to the Trustee's Objection and moved the Court to enter an Order allowing the government's claim because the claim was predicated upon the statutory liability of Onofre J. Sotelo and Naomi Sotelo pursuant to the provisions of Section 6671 and 6672 of the Internal Revenue Code of 1954.

At the hearing before Judge Covey the bankrupts were represented by their own counsel and the issue raised was that the bankrupts were not responsible officers of the corporation and therefore were not personally liable for unpaid social security and withholding taxes.

On November 29, 1974 Judge Covey allowed the claim of the Internal Revenue Service in the amount of $32,840.71. In his Opinion he found that Onofre J. Sotelo was the chief executive officer, president and majority stockholder of the corporation and was charged with the duty and responsibility to see that the social security and withholding taxes were paid. He further found that Naomi Sotelo was not personally liable for the taxes "as far as the assets of her bankruptcy estate is concerned." The Court continued

and stated "however, this is immaterial because the estates have been merged."

On September 14, 1973 the Trustee allowed Onofre J. Sotelo a $10,000 Homestead in certain real estate occupied by the Sotelo family the title to which was in Onofre J. Sotelo and Naomi Sotelo as joint tenants. The Trustee denied Onofre J. Sotelo's claim of Homestead.

This came about because in the original Schedules filed by the bankrupts each claimed a $5,000 Homestead in the same property.

Since the Sotelo's had a substantial equity in the property the property was sold on March 8, 1974 by the Trustee free and clear of liens. The Order of Sale provided that the liens were to attach to the proceeds of the sale.

On May 1, 1974 a hearing was held to determine the validity, priority and amount of liens against the proceeds of the sale, and on May 7, 1974 the Court found that Kewanee Federal Savings & Loan and Beauty Stain Products had valid liens against the property. Nothing was said in this Order concerning the lien of the United States of America. The balance of the proceeds, including the $10,000 representing Onofre J. Sotelo's Homestead, was held by the Trustee pending the outcome of the litigation concerning the objections to the claim of the Internal Revenue Service.

No action was taken by the Trustee after Judge Covey's Decision on November 29, 1974 to turn the money over to the Internal Revenue Service and on

October 2, 1975 the Internal Revenue Service filed and served a Notice of Levy on the Trustee which stated as follows:

> "This levy is intended to attach to the Homestead Exemption otherwise payable to Onofre J. Sotelo."

On October 24, 1975 the Internal Revenue Service served its final demand on the Trustee and on October 31, 1975 the Trustee filed an Application for an Order directing him to pay the $10,000 proceeds of the Homestead Exemption set off by the Trustee to Onofre J. Sotelo to the Internal Revenue Service.

The Application was set for hearing on December 12, 1975. At the hearing, new counsel for Mrs. Sotelo appeared and asked leave to file a Brief with the Court. Leave was given and the matter was taken under Advisement.

THE ISSUES

Mrs. Sotelo contends (1) that she is entitled to the entire $10,000 Homestead because her husband could not deprive her of her Homestead; (2) since the 1970 Illinois Constitution provides in Article I, Sec. 18, that "the equal protection of the law shall not be denied or abridged on account of sex * * *", that she is entitled to the Homestead; and (3) that the claim of the Internal Revenue Service was based on a tax on the corporation and not on the bankrupt O. J. Sotelo, and therefore it is discharged in bankruptcy.

STATEMENT OF FACTS

The facts are undisputed.

In the Statement of Affairs signed by O. J. Sotelo in the corporate bankruptcy he stated that he had been engaged in business as an individual proprietor between 1962 and October 28, 1970 when he caused the business to be incorporated in the State of Delaware.

In the Statement of Affairs in his individual bankruptcy Mr. Sotelo states that he was a self-employed masonry contractor and that his business was incorporated in 1970. He further stated that his income for the years 1971 and 1972 amounted to approximately $15,000 each year.

In the Statement of Affairs in Mrs. Sotelo's individual bankruptcy she stated that she was a "housewife", and that her income during the years 1971 and 1972 amounted to approximately $3,370.00 each year.

In Schedule B-4 of his Bankruptcy Schedules, for the purpose of claiming $1,000 personal property exemption, Mr. Sotelo stated that he was the head of a household consisting of himself, his wife, and four children. In her Schedule B-4 Mrs. Sotelo claimed $300 personal property exemption.

Chapter 52, Sec. 13 Illinois Revised Statutes provides for Personal Property Exemptions of $300 worth of property to be selected by the debtor and, in addition, when the debtor is the head of the family and resides with the same he shall be entitled to an additional $700 worth of property as exempt.

In each of their schedules each claimed a $5,000 Homestead pursuant to Chapter 52, Sec. 1 Illinois Revised Statutes. This Statute gives a $10,000 Homestead to "every householder having a family."

On August 13, 1973 Onofre J. Sotelo filed an Application to Amend his Schedules in order to claim a $10,000 Homestead Exemption instead of $5,000 and on September 12, 1973 he filed an Amendment to his Schedules claiming a Homestead of $10,000 pursuant to the provisions of Section 1 of Chapter 52 Illinois Revised Statutes. Two days later, on September 14, 1973, the Trustees set aside the Homestead to him.

DISCUSSION

Homestead

In her Brief Naomi Sotelo contends that the Illinois Statute allowing a Homestead Exemption is more than an exemption but is actually an estate in land, and that therefore the action of Mr. Sotelo claiming the entire homestead does not deprive her of her rights. The cases cited in her Brief are inapposite. In this regard the statement is made, without citation of authority, that because of the tax claim the entire Homestead Exemption vests in the wife and should be paid to her instead of his creditors. This is a spurious argument and is of no merit.

The right of Homestead is ineffective as against federal tax liens and levies regardless of whether it is described under state law as an exemption or a property interest. *In Herndon* v. *United States*, 501 F.2d

1219 (8th Cir. 1974), the Court stated at pages 1222-23:

> "We think the sounder view in this area of conflicting approaches is that state exemption laws —even if the state, through case interpretation, statute, or constitutional provisions, characterizes its homestead exemption statute as creating a present property interest—do not preclude the United States from levying upon and selling the taxpayer's interest in the property."

Int. Rev. Code of 1954, Sec. 6334, after listing property (not including homesteads) exempt from levy for federal taxes specifically states that notwithstanding any other law of the United States, no property or rights to property shall be exempt other than the property specifically listed in that section.

Mrs. Sotelo has no Homestead in the property under the law of Illinois and of his [*sic*] District. The law in this District is settled by the Opinion of Judge Robert D. Morgan in the case in *In re Hendricks*, 300 F. Supp. 774 (1969). In that case Mr. & Mrs. Hendricks were adjudicated bankrupts. On the date of bankruptcy they owned a residence in Victoria, Illinois as joint tenants. In their Schedules each claimed a $5,000 Homestead Exemption in said real estate pursuant to the provisions of Chapter 52, Sec. 1 Illinois Revised Statutes. The Trustee filed a petition, in each case, requesting the Court to determine the proper allowance and allocation of the Homestead exemption. The Court held that the law is clearly established in Illinois that where a husband and wife own property as joint tenants and reside together on

the premises that the husband is the householder contemplated by the Statute and he alone is entitled to the Homestead Exemption.

The Court relied on several cases. One case is *Morris Investment Co.* v. *Skeldon*, 399 Ill. 506, where the Supreme Court of Illinois held that the husband's interest as householder extends to the entire property, not just to his undivided interest.

Other cases cited by Judge Morgan are *Johnson* v. *Muntz*, 364 Ill. 482, (1936) and *DeMartini* v. *DeMartini*, 384 Ill. 124 (1944).

In order for a wife to be the head of a family or "householder" for the purposes of Homestead laws, where there is a husband, she must in fact be the controlling or supporting force in the family and there must be dependence upon her by the family. *First National Bank & Trust Co. of Rockford* v. *Sandifer*, 121 Ill. App.2d 479 (1970).

Ordinarily, the husband, if living, and residing with his family, is the householder contemplated by the Homestead Act so as to vest a Homestead Estate in him, even though the premises of which they reside are owned by both husband and wife as joint tenants. 20 I.L.P. Homestead Sec. 25, *LaPlaca* v. *LaPlaca*, 5 Ill.2d 468 (1955), *DeMartini* v. *DeMartini*, *supra; Johnson* v. *Muntz*, *supra.*

Separate homesteads in favor of different persons cannot exist in the same premises at the same time. 29 I.L.P. Homestead Sec. 6, *LaPlaca* v. *LaPlaca*, *supra; Morris Investment Co.* v. *Skeldon*, *supra; Johnson* v. *Muntz*, *supra.*

Under proper circumstances, a wife, although living with her husband, may be the householder in whom the Homestead Estate is vested. *DeMartini* v. *DeMartini*, 386 Ill. 128 and *First National Bank* v. *Sandifer*, *supra.*

In this case it is clear that Mr. Sotelo was the householder, he was the head of the family, he was supporting the family, they were dependent upon him for support and they were not dependent on Mrs. Sotelo for support and she was not the householder entitled to a Homestead Exemption.

THE FEDERAL LIEN

The Federal Statutes grant a lien in favor of the United States "upon all property and rights to property" belonging to any person for unpaid delinquent federal taxes. The collector of Internal Revenue, or his deputy is authorized to enforce the collection of the delinquent and unpaid taxes by levying upon "all property and rights to property except those specifically exempted by Federal Statutes." Sections 6331 and 6334 of the Internal Revenue Code of 1954 (26 U.S.C. 6326, 6331, 6334). Homesteads are not specifically exempt by said statutes and therefore are subject to the lien of the federal tax and the levy.

Once the state law has been applied to ascertain the taxpayer's state-created property interest, to govern the determination of the taxpayer's interest in the property to which the lien attaches, we enter the province of federal law in subjecting the property in-

volved to the discharge of the tax liability. *United States* v. *Bess*, 357 U.S. 51; *Aquillino* v. *U.S.*, 363 U.S. 509.

Since Mrs. Sotelo does not have a Homestead in the property and Mr. Sotelo does have a Homestead in the property the lien of the Federal Government attaches to the $10,000 proceeds in the hands of the Trustee.

DISCHARGEABILITY

The contention is made that the tax is not a tax on Onofre J. Sotelo but it is in the nature of a compensatory penalty, and therefore nondischargeable.

The basis for this argument is not specifically set forth. The taxpayer admits that in *Sherwood* v. *United States*, 228 F.Supp. 247, and *Westenberg* v. *United States*, 285 F.Supp. 915, the Courts held that the penalty under Section 6672 of the Internal Revenue Code is not dischargeable in bankruptcy.

Mrs. Sotelo fails to make any reference to the pertinent statutory provisions. Section 17 of the Bankruptcy Act (11 U.S.C. Sec. 35) relates to debts not affected by a discharge. It first provides that debts not affected by a discharge are taxes which became legally due and owing by the bankrupt to the United States within three years preceding the bankruptcy. It also provides in subparagraph a(1) (e) that taxes are not dischargeable which the bankrupt has collected or withheld from others as required by the laws of the United States but has not paid over such taxes. It also provides that a discharge shall not be a bar to any remedies available under applicable law to the United States against the exemption of the bankrupt allowed by law and duly set apart to him under this Act. In addition to these provisions the Act also states that a discharge in bankruptcy shall not release or affect any tax lien.

Section 57j of the Bankruptcy Act (11 U.S.C. Sec. 93) provides in substance that debts owing the United States as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the transaction out of which the penalty or forfeiture arose.

As stated in *1A Collier on Bankruptcy* 14th Edition, Section 17.13, pages 1609 and 1610, although the Bankruptcy Act does not make specific provisions concerning the dischargeability of fines and penalties due to the United States certain principles have become well settled in this connection. Thus, fines and penalties are not affected by a discharge.

As stated by the author in *1A Colliers* at page 1623 with reference to the survival of tax claims against exempt property the author cites the case of the *United States* v. *Bess*, 357 U.S. 51, which holds that generally speaking federal tax claims are not subject to state exemption laws.

Finally it should be noted that the tax involved is not a "penalty". Though denominated a "penalty" it is in substance a tax. *Kelly* v. *Lethert*, 362 F.2d 629, *Braden* v. *United States*, 442 F.2d 342, cert. denied 404 U.S. 912. It has also been described as imposing a civil liability. *United States* v. *Industrial*

Crane and Manufacturing Corp., 492 F.2d 772, *Cash* v. *Campbell*, 346 F.2d 670.

In view of the foregoing authorities there is no merit in the bankrupt's contention that the tax has been discharged.

CONSTITUTIONAL VIOLATION

In connection with the argument that Mrs. Sotelo does not have any Homestead because her husband was not dependent upon her for support she now contends that this "male chauvinist" argument has absolutely no validity. The United States Supreme Court she claims has spoken repeatedly on the issue that sex is a suspect classification, and must have some rational basis to be upheld.

As indicated above the Homestead Exemption Law Act of the State of Illinois does not distinguish rights based on sex. The difference in who is entitled to a Homestead depends on who is the person supporting the family whether it be a male or a female.

Chapter 52 Section 1 Illinois Revised Statutes creates a Homestead for "every householder having a family." It does not state that it is every male householder. Section 2 of this Act provides that the Homestead continues after the death of such householder for the benefit of the "husband or wife surviving." Section 4 of the Act provides that a conveyance of a Homestead must be signed by the householder and "his or her spouse if he or she have one."

Section 13 of Chapter 52 relating to Exemptions of Personal Property provides that the "debtor" may

select $300 worth of property, and in addition, when the "debtor" is the head of the family and resides with the same he or she may have an additional $700 exemption.

At common law there was no such thing as a Homestead Right. Homestead Rights, therefore, exist only by virtue of constitutional or statutory rights creating them. 40 C.J.S. Homestead Sec. 2.

The exemption of property of a debtor from liability for the payment of his debts is purely a statutory right. 19 I.L.P. Exemptions Sec. 2.

"Homestead" is wholly statutory and the elements may be changed by the Legislature. *Petruluonis* v. *Dudek*, 113 Ill. App.2d 398, 252 N.E.2d 23, 20 I.L.P. Homestead Sec. 2.

It is interesting to note that if Mrs. Sotelo's position is correct namely that this law is unconstitutional this would be of no benefit to her because there would be no homestead laws on the books of the State of Illinois. The general rule is that a statute declared unconstitutional is null and void. 16 CJS Constitutional Law Sec. 101.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The Statement of Facts contained herein shall constitute Findings of Fact under Rule 752 of the Bankruptcy Rules and the discussion of the legal propositions in the foregoing Discussion shall constitute

Conclusions of Law under Rule 752 of the Bankruptcy Rules.

DATED at Peoria, Illinois, this 23rd day of January, 1976.

/s/ Max J. Lipkin
MAX J. LIPKIN
Bankruptcy Judge

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS
NORTHERN DIVISION

No. RI BK 73 233 & No. RI BK 73 234

MERGED CASES

[Filed Feb. 23, 1976, William J. Littell, Clerk]

IN RE

ONOFRE J. SOTELO AND NAOMI SOTELO, BANKRUPTS.

DECISION AND ORDER ON APPEAL

This is an appeal from an Order of the Bankruptcy Judge, directing the trustee of the merged estates herein to pay to the Internal Revenue Service the sum of $10,000, representing the proceeds of a homestead exemption previously set off by the trustee to Onofre J. Sotelo. It is contended by the bankrupts that such exemption, failing in the husband Onofre against the government claim, is available to the wife, Naomi.

This court has read and considered the entire record on appeal, including all arguments of counsel in briefs. While the arguments of the bankrupts' counsel may be considered ingenious and vigorous representation of the clients' financial interests, it becomes apparent, upon objective consideration, that they have all been discussed and decided correctly

under the applicable laws in the Opinion filed herein by the Bankruptcy Judge on January 23, 1976. Further hearing thereon or discussion here would serve no useful purpose.

Accordingly, IT IS ORDERED that the Order of the Bankruptcy Judge herein filed January 23, 1976, is AFFIRMED on appeal in this court.

/s/ Robert D. Morgan
ROBERT D. MORGAN
United States District Judge

Entered: February 23, 1976

APPENDIX C

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 76-1429

IN THE MATTER OF ONOFRE J. SOTELO and NAOMI SOTELO, Bankrupts.

Appeal in Bankruptcy from the Order of the United States District Court for the Southern District of Illinois, Northern Division

Nos. RI-BK-73-233 and RI-BK-73-234

Robert D. Morgan, *Judge.*

HEARD DECEMBER 3, 1976—DECIDED MARCH 24, 1977

Before BAUER, WOOD, *Circuit Judges*, and GRANT, *Senior District Judge.**

BAUER, *Circuit Judge.* Appellant Onofre J. Sotelo contends that the district court erred in not discharging in bankruptcy a liability imposed upon him under 26 U.S.C. § 6672 for failing to account to the government for taxes withheld from the wages of the employees of the corporation of which he was chief executive officer. The question on review is whether

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* The Hon. Robert A. Grant, United States District Court for the Northern District of Indiana, is sitting by designation.

the liability is a nondischargeable tax or a dischargeable penalty.

Sotelo does not challenge his liability under 26 U.S.C. § 6672.[1] He only argues that the liability should have been discharged by his personal bankruptcy petition. Sotelo bases has argument on Section 17 of the Bankrupty Act, 11 U.S.C. § 35, which provides in pertinent part:

> "§ 35. Dischargeability of debts—Debts not affected by discharge
>
> (a) A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankruptcy: *Provided, however,* That a discharge in bankruptcy shall not release a bankrupt from any taxes . . . (e) which the bankrupt has collected or withheld from others as required by the laws of the United States or any State or political subdivision thereof, but has not paid over . . . ."

[1] "§ 6672. Failure to collect and pay over tax, or attempt to evade or defeat tax

Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable."

The Bankruptcy Judge proved and allowed Sotelo's liability. The liability thus is dischargeable under Section 17 unless it is a "tax . . . legally due and owing by the bankrupt to the United States." Sotelo maintains that his liability cannot be a nondischargeable "tax" because 26 U.S.C. § 6672 calls it a "penalty." Under his view, only the employer corporation obligated to withhold the funds is liable for a "tax." 26 U.S.C. § 3402.

The government recognizes that Section 6672 explicitly imposes a "penalty" rather than a "tax", but relies on an uncontroverted line of cases that repudiate the statutory language and hold that a Section 6672 liability is a nondischargeable tax for bankruptcy purposes. *In re Murphy*, 533 F.2d 941, 942 (5th Cir. 1976), *aff'g In re Murphy*, 381 F.Supp. 813 (N.D. Ala. 1974); *Westenberg* v. *United States*, 285 F.Supp. 915 (D. Ariz. 1968); *Lynn* v. *Scanlon*, 234 F.Supp. 140 (E.D.N.Y. 1964); *Sherwood* v. *United States*, 228 F.Supp. 247 (E.D.N.Y. 1964).

Notwithstanding this contrary precedent, we reverse the district judge and hold the liability to be a dischargeable debt.

All the cases cited by the government rely on *Botta* v. *Scanlon*, 314 F.2d 392 (2d Cir. 1963), which holds that the liability imposed under Section 6672 is a "tax" within the meaning of the Internal Revenue Code's Anti-Injunction Statute, applicable to suits brought to restrain "the assessment or collection of any *tax*" (emphasis added). 26 U.S.C. § 7421(a).[2]

[2] 26 U.S.C. § 7421(a) provides in full:

"(a) Tax.—Except as provided in sections 6212(a) and (c), 6213(a), and 7426(a) and (b)(1), no suit for the

The *Botta* court based its decision on Section 6671 of the Internal Revenue Code. Section 6671 mandates that

> "any reference in this title [which includes the Anti-Injunction Statute] to 'tax' imposed by this title shall be deemed also to refer to the penalties and liabilities provided by this subchapter [which includes Section 6672]."

No provision equivalent to Section 6671 applies to references to "taxes" in the Bankruptcy Act. *Botta's* holding that a Section 6672 "penalty" is a "tax" for purposes of the Anti-Injunction Statute, premised as it is on the clear language of Section 6671, cannot be extended to the bankruptcy context.

The government's cases support their result by explaining that Section 6672

> "is not a penalty as that term is generally used, but in reality is a liability for a tax originally imposed upon the corporation and shifted to the corporate officer upon his default." *Sherwood* v. *United States, supra* at 251.

More a characterization than an analysis, this rationale is insufficient to override Congress' own characterization of the liability it created in Section 6672.

The government's alternative ground, 11 U.S.C. § 35(a)(1)(e), suffers from the same disability as

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purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed.

its primary ground. Section 35(a)(1)(e) provides that

> "a discharge in bankruptcy shall not release a bankrupt from any taxes . . . which the bankrupt has collected or withheld from others as required by the laws of the United States . . . but has not paid over. . . ."

This proviso was enacted to make withholding taxes collected by the bankrupt but not paid over to the government nondischargeable no matter how long past due. Without it, Section 35(a)(1) would discharge all such taxes except those "due . . . within three years preceding bankruptcy." H.R. Rep. No. 687, 89th Cong., 1st Sess. 1, 5-6 (1965). Because the proviso renders only "taxes" nondischargeable, not a "penalty" imposed under 26 U.S.C. § 6672, it cannot be applied to Sotelo's liability. Moreover, Section 35(a)(1)(e) applies only to taxes "which the bankrupt has collected or withheld from others as required by the laws of the United States", and it was not Sotelo himself, but his employer-corporation, that was obligated by law to collect and withhold the taxes governed by the proviso. 26 U.S.C. § 3402.

As a policy matter, the government's position that Sotelo remains personally liable, notwithstanding bankruptcy, for taxes required to be withheld by his corporation, can lead to substantial inequities. When an individual remains personally liable after bankruptcy for his own taxes, there is at least some connection between the amount of the liability and the sum of his taxable assets. This nexus is absent when

an individual is held liable for a tax owed by a corporation. The corporate liability might vastly exceed the individual's present or future resources. Indeed, the bankrupt's entire future earnings could be confiscated to compensate for the corporate liability, a result that would contravene the Bankruptcy Act's basic policy of settling a bankrupt's past debts and providing a fresh economic start. Declining to bring about such a possibility, we hold the Section 6672 liability dischargeable in bankruptcy.[3]

Any uncertainty created by the conflict between our holding and established precedent, albeit not binding precedent, seems a low price to pay for achieving the basic purpose of the Bankruptcy Act by respecting the statutory language of the Act and the Internal Revenue Code.[4]

REVERSED and REMANDED.

A true Copy:
Teste:

Clerk of the United States
Court of Appeals for
the Seventh Circuit

[3] By so holding, we need not consider Sotelo's alternative argument that Mrs. Sotelo is entitled to a state homestead exemption free from her husband's Section 6672 liability.

[4] This opinion has been circulated among all judges of this court in regular active service. No judge favored a rehearing in banc on the question of the conflict with the Fifth Circuit's holding in *In Re Murphy*, 533 F.2d 941 (1976).

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Chicago, Illinois 60604

March 24, 1977

Before

Hon. William J. Bauer, Circuit Judge
Hon. Harlington Wood, Jr., Circuit Judge
Hon. Robert A. Grant, Senior District Judge*

No. 76-1429

IN THE MATTERS OF:

ONOFRE J. SOTELO and NAOMI SOTELO, Bankrupts.

Appeal from the United States District Court
for the Southern District of Illinois,
Northern Division

Nos. RI-BK-73-233 and 234

Robert D. Morgan, Judge

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Illinois, Northern Division, and was argued by counsel.

* Honorable Robert A. Grant, Senior Judge, United States District Court for the Northern District of Indiana, sitting by designation.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, REVERSED, with costs, and REMANDED, in accordance with the opinion of this court filed this date.

APPENDIX E

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 6672. FAILURE TO COLLECT AND PAY OVER TAX, OR ATTEMPT TO EVADE OR DEFEAT TAX.

Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable.

Bankruptcy Act, c. 541, 30 Stat. 544, Sec. 17 [as amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 840, 851] (11 U.S.C. 35):

Sec. 17. *Debts not affected by a discharge.*

a [as amended by Sec. 2, Act of July 5, 1966, P.L. 89-496, 80 Stat. 270]. A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankruptcy: *Provided, however,* That a discharge in bankruptcy shall not release a bankrupt from any taxes (a) which were not assessed in any case in which the bankrupt failed

to make a return required by law, (b) which were assessed within one year preceding bankruptcy in any case in which the bankrupt failed to make a return required by law, (c) which were not reported on a return made by the bankrupt and which were not assessed prior to bankruptcy by reason of a prohibition on assessment pending the exhaustion of administrative or judicial remedies available to the bankrupt, (d) with respect to which the bankrupt made a false or fraudulent return, or willfully attempted in any manner to evade or defeat, or (e) which the bankrupt has collected or withheld from others as required by the laws of the United States or any State or political subdivision thereof, but has not paid over; but a discharge shall not be a bar to any remedies available under applicable law to the United States or to any State or any subdivision thereof, against the exemption of the bankrupt allowed by law and duly set apart to him under this Act: *And provided further*, That a discharge in bankruptcy shall not release or affect any tax lien;

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